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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1966.

No. ~~1300~~ 208

CHICAGO CUTTER KARCHER, INC.,
Petitioner,

vs.

CHARLES D. MALEY, Trustee of Lords, Inc., Bankrupt,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

**To United States Court of Appeals,
Seventh Circuit.**

VICTOR PACKMAN,
1096 Arcade Building,
St. Louis, Missouri 63101,

CHARLES R. SPROWL,
WALTER C. CLEMENTS,
TAYLOR, MILLER, MAGNER, SPROWL
& HUTCHINGS,
120 South LaSalle Street,
Chicago, Illinois,

Attorneys for Petitioner.

ST. LOUIS LAW PRINTING CO., INC., 415 N. Eighth Street. CEntral 1-4477.

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vs.

CHARLES D. MALEY, Trustee of Lords, Inc., Bankrupt,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

**To United States Court of Appeals,
Seventh Circuit.**

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals, Seventh Circuit, **In the Matter of Lords, Inc., Bankrupt, Chicago Cutter Karcher, Inc., Petitioner-Appellant v. Charles D. Maley, Trustee, Respondent-Appellee, 356 F. (2d) 456***

JURISDICTION.

The judgment of the Court of Appeals (affirming the orders of the Referee and District Judge) was rendered December 17, 1965 and judgment entered the same day. Petition for rehearing and suggestions for rehearing en banc (duly filed) were denied March 9, 1966.

Jurisdiction to review the judgment is invoked under Title 11 U. S. C. Section 47 (c) and Title 28 U. S. C. Section 1254 (1).

* Majority opinion is on page 13 hereof and dissenting opinion is on page 19.

QUESTIONS PRESENTED.

1. Whether language in a department store lease providing that the proceeds of sale of goods belonging to Lessee (Petitioner herein) sold by its employees and turned over to Lessor

> ". . . shall be considered to be held by Lessor in Trust for Lessee and if mingled with Lessor's funds either in cash drawer or deposit in bank . . . shall nevertheless be considered trust funds . . . to be held by Lessor in trust for Lessee until Lessor has paid to Lessee the total amount of such sales and receipts in accordance with the provisions hereof"

failed to express the intention of a continuing trustee, beneficiary relationship with reference to such proceeds of sale even if commingled by Lessor with funds of Lessor.

2. Whether a further provision in the department store lease with specific reference to proceeds of sale of Petitioner's goods stating

> ". . . In the event title to said funds shall at any time be called into question, the parties hereto desire to clearly indicate their intention that these funds shall be and are hereby considered and regarded by the parties hereto as trust funds irrespective of whether they are commingled or not, and said funds shall be held in trust for the benefit of Lessee"

may be repudiated by the Trustee in Bankruptcy of Lessor, and whether the provision may be nullified by a ruling that only a creditor-debtor relationship was intended by the parties.

3. Whether the Trustee in Bankruptcy of Lessor may retain funds of Petitioner because the lease agreement did not specifically provide for creation of a separate bank account for their deposit, although the funds in issue have been traced into the general bank account of Lessor and there is no issue in the case as to tracing.

STATEMENT OF CASE.

Agreement.

Petitioner, as Lessee, entered into a written agreement with Lord's, Inc., as Lessor wherein Lessee was assigned a space in the store of Lessor at Evanston, Illinois, for the sale at retail of Lessee's shoes and related accessories.[1]

Sales from the shoe department were to be made by Lessee's employees.[2] Casualty, workmen's compensation, and public liability insurance and taxes and license fees were to be paid for by Lessee.[3] Proceeds of sale of Lessee's merchandise were to be turned over to Lessor, which was obligated by the agreement to keep a true and accurate account of such moneys and of money disbursed on Lessee's authorization, with Lessee being given right of examination of such details as well as of sales slips and records.[4]

Article Sixteenth of the agreement stipulated:

> "All cash sales and all charge sales shall be made in the name of Lessor and shall be recorded by Lessor at its expense. All moneys received by Lessee or its employees representing the proceeds of the sale of goods sold in said department by or through Lessee or its employees shall immediately be turned over to Lessor. All the moneys received and accounts so received by Lessor on account of sales in said department shall be considered to be held by Lessor in Trust for Lessee, and if mingled with Lessor's funds, either in cash drawer or deposit in the bank, or where-

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[1] Agreement is on pages 17-24 of Appendix to appellant's brief.

[2] Article Third, p. 18 app.

[3] Article Sixth, p. 19 app.

[4] Article Tenth, p. 20 app.

ever such commingling may be effected, such funds shall nevertheless and hereby are considered trust funds, and are to be so held by Lessor in trust for Lessee until Lessor has paid to Lessee the total amount of such sales and receipts in accordance with the provisions hereof. In the event title to said funds shall at any time be called into question the parties hereto desire to clearly indicate their intention that these funds shall be and are hereby considered and regarded by the parties hereto as trust funds irrespective of whether they are commingled or not, and said funds shall be held in trust for the benefit of Lessee."

No disbursement to Lessee's employees were to be made by Lessor **"out of money in its hands due Lessee"** unless authorized by the general office of Lessee.[5] Lessee was to keep its own payroll which when presented to Lessor for payment was to be paid by Lessor **"out of the moneys in its hands due to Lessee and deducted therefrom when making settlement."**[6]

Lessee agreed to pay Lessor for the "lease and privileges" granted a sum equal to 12% of its net cash sales and charge sales. "Rental due" was "deductible from periodic settlement covering sales made during period covered in the remittance."[7]

Article Fourteenth of the agreement read:

"It is understood and agreed that the receipts of Lessee's sales shall be payable to Lessor, and Lessor will **repay the same** to Lessee in the following manner; on or before the 15th day of each month Lessor will pay to Lessee the amount of all net cash sales,

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[5] Article Eleventh, p. 20 app.

[6] Article Twelfth, pp. 20-21 app.

[7] Article Thirteenth, p. 21 app.

and on or before the 15th day of each month Lessor will pay to Lessee the amount of all gross charge sales, less returns made charged to Lessee, for the preceding month, less the amount payable by Lessee hereunder. Should Lessor or Lessee decide to terminate this agreement, Lessor agrees to make full settlement at once to Lessee of all moneys which are due Lessee up to and including the last day's sales in said department." (Emphasis ours.)

Lessee retained the right to remove its stock and any other chattels in the event the Lessor breached the agreement with respect to remittance, and Lessor agreed in such event immediately to account to Lessee for all sales, both cash and charge, up to the time of termination of the agreement.[8]

Bankruptcy.

When an involuntary petition in bankruptcy was filed against Lord's, Inc., on June 16, 1964, it was only one day past due in its accounting and remittance of proceeds of sale of Lessee's shoes for the month of May, such proceeds amounting (net) to $9,553.16. The leased shoe department continued to operate and on July 2, 1964, Lord's, Inc., filed its petition for reorganization as a Debtor in the United States District Court and was permitted to carry on. It was at that time accountable for $7,536.00 of additional proceeds of sales of Lessee's shoe department from the 1st day of June to July 2, 1964.

A reclamation petition[9] was thereafter filed by Petitioner in the Bankruptcy Court,[10] seeking the recovery from the Debtor of the money or the traceable proceeds

[8] Article Fifteenth, p. 21 app.

[9] Page 4 of Appendix.

[10] It had jurisdiction of said petition under Section 2 (7), of the Bankruptcy Act 11 U. S. C., Section 11 (7).

thereof which had come into its possession as Lessor from the sale of Petitioner's merchandise.

The Debtor filed an answer admitting the lease agreement but stating "regardless of the terms set out in said lease agreement, Chicago Cutter-Karcher, Inc., knew that your respondent maintained at no time during the aforementioned lease agreement a separate bank account for its alleged receipts . . ."; further, that "all of its business relationship with Chicago Cutter-Karcher was always done on a basis of creditor and debtor on open account, upon which an account stated was determined every thirty days and payment thereunder by your respondent."

The answer of Debtor was later adopted by the Trustee in Bankruptcy but at the hearing on the reclamation petition he offered no evidence. His attorney conceded, however, there was no issue as to the amount due Petitioner under the lease agreement or as to the tracing of funds. He also conceded there were sufficient funds in the general account at Lord's, Inc., to cover the amount claimed by Petitioner.

Testimony Re Separate Records.

The controller of Lord's, Inc. (Mr. John F. Cole), testified with reference to the records of the Lessor relating to the shoe department:

> "That he had been controller of Lord's, Inc., from 1952 until the middle of September, 1964, and that he was aware of the contract between Lord's, Inc., and Chicago Cutter-Karcher and the subsequent supplement thereto; that he had occasion to refer to the contract and that he was familiar with the contents. He stated daily sales records from the sales checks were submitted from the leased shoe depart-

ment and that a summary was made daily of what the register showed in the shoe department, which had a department number 93 to distinguish it from others, and that the dailies reflected the amount of cash and charge sales on a particular day; that Lord's, Inc., had one central bank account for receipts and if money was needed for withholding taxes it would also come out of the central account; that he had a ledger sheet marked 'Dept. 93' pertaining to Chicago Cutter-Karcher, and at the end of a month the daily sales and amounts due Chicago Cutter-Karcher were summarized and entered. This record was kept separate from other payables."

A narrative of additional evidence presented by Petitioner is contained on pages 9 to 16 of appendix to Appellant's Brief, **said appendix** being part of the record certified by the Clerk of the United States Court, Seventh Circuit; the Order of the Referee is on pp. 27 to 32 thereof; the Petition for Review is on pp. 33 to 39; and the Order of the District Judge is on pp. 58 to 60.

REASONS FOR GRANTING THE WRIT OF CERTIORARI.

1. The Court of Appeals by a split decision*** has decided a matter of importance in the administration of the Bankruptcy Act and of substantive law in conflict with decisions of other United States Courts of Appeal and of this Court.

(a) The Court of Appeals has erroneously decided that the terms of an express trust in a department store lease agreement may not be enforced in a bankruptcy reclamation proceeding where the agreement did not provide for

*** On suggestions for a transfer of petition for a rehearing to the Court en banc Judges Elmer J. Schnackenberg and Luther M. Swygert voted to grant the petition.

the funds turned over to the Lessor from the sale of Lessee's merchandise to be kept in a separate **bank** account for the Lessee. It cited, and misinterpreted **U. S. National Bank v. Blauners Affiliated Stores, Inc., Third Cir.** (1935), **75 F. 2d 826**, which did not rule to that effect but, in essence, supports this petition. Also see **South Falls Corporation v. Rochelle, Fifth Cir.** (1964), **329 F. 2d 617.**

(b) The decision runs counter to the following cases in which the obligation of a fiduciary and the equities of a beneficiary were not obliterated by virtue of commingling of trust funds or failure of the agreement to provide for a separate bank account for the deposit of trust funds which could be traced.

Central National Bank v. Insurance Co., 104 U. S. 54, 66-71;

Ludvigh v. American Woolen Co., 231 U. S. 522, 526, 529;

Southern Cotton Oil Co. v. Elliotte, Sixth Cir. (1914), 218 F. 567, 570, 571;

Dryden v. Michigan State Industries, Eighth Cir. (1933), **66 F. 2d 950, 954;**

General Electric Co. v. Brower, Ninth Cir. (1915), **221 F. 597, 601;**

In re Warner Quinlan Co., Second Cir. (1936), **86 F. 2d 103, 104;**

McCallum v. Anderson, Tenth Cir. (1945), **147 F. 2d 811, 814;**

McBryde v. Burnett, Fourth Cir. (1943), **132 F. 2d 898, 900.**

(c) The decision is not in harmony with the principle that a trustee in bankruptcy succeeds only to the title and rights in property that the particular debtor had formerly possessed; and that, where the debtor had been in possession of trust property, the bankruptcy trustee holds such

property subject to the outstanding interest of the beneficiaries and must recognize them.

Collier, Bankruptcy, ¶ 70.25 [1] (14th ed. 1964);
Remington on Bankruptcy (Henderson), Vol. 3, Sec. 1212;
City of Dallas v. Crippen, Fifth Cir. (1948), **171 F. 2d 526, 529;**
In Re Klein, Second Cir. (1924), **3 F. 2d 375, 377;**
Zartman v. First National Bank, 216 U. S. 134, 138.

2. The issues in this matter are of utmost importance, not only to Petitioner, which, with affiliates, operates more than 90 shoe departments under clauses identical to the one ruled on, but to thousands of other similar lease operations by mercantile firms in various lines of retail establishments throughout the United States. The disturbing effect of the decision upon time honored business procedures, and the law pertaining to fiduciary relationships, and the apparent conflict with well established precedents merit a review by this Court.

ARGUMENT.

The majority opinion misinterpreted **U. S. National Bank v. Blauners Affiliated Stores, Inc.**, Third Cir. (1935), 75 F. 2d 826, cited in support of its conclusion.

The three department lease contracts which were before the Court in that case are set out on pp. 18-37 of appendix to the Petition for Rehearing filed (part of the duly certified record).

In each of the contracts the merchandise was admittedly owned by the Lessees and the selling expense borne by them, although all sales and advertising were under the store name. Each contract provided for proceeds of cash and charge sales in the leased department to be turned over to and handled by the Lessor which had a percentage rental arrangement based on sales. **In none of the contracts was there a requirement for proceeds of sale of Lessee's merchandise to be kept in a segregated place or separate bank account, or an affirmative prohibition against commingling of department proceeds.** All the contracts provided for making remittances to Lessees on the 10th of the following month for cash and charge receipts minus amounts due to the department store for commissions and various advances.

Although the opinions of the lower court **In Re Kline**, 7 Fed. Supp. 850 (W. D. Pa. 1934), and of the Third Circuit which affirmed the said opinion *sub nom* in **U. S. National Bank v. Blauner's Affiliated Stores, Inc.** (supra) left unclear whether the contracts therein ruled on provided for separate **bank** accounts, it can be verified from the contracts that they did not. The references to a **separate account** in the District Court's opinion in **In Re Kline**, which language was adopted by the Appellate Court, must have been to a separate bookkeeping record. In the present case there were such records pertaining to

the leased shoe department and the evidence to that effect came from the controller of the Lessor.

There is nothing in the modern law of Trusts which nullifies a fiduciary relationship merely because the fiduciary has commingled trust funds with his own, or which makes the relationship dependent upon an express obligation on the part of the fiduciary to keep the funds segregated or in a separate bank account.

Trust funds which have been commingled and can be traced do not lose their trust character. ". . . equity will follow the money, even if put into a bag or an undistinguishable mass, by taking out the same quantity." **National Bank v. Insurance Company**, 104 U. S. 54, 69. In the same case we read: ". . . that there is no distinction between an express trustee and an agent, or bailee, or collector of rents, or anybody else in a fiduciary position . . ." (l. c. 68).

The trustee in bankruptcy was not an innocent purchaser. He must recognize and cannot properly repudiate any rights to property which comes into his possession, which the bankrupt would have had to recognize. "He cannot . . . upset an otherwise valid trust which the bankrupt created while solvent." **Remington on Bankruptcy** (Henderson), Vol. 3, Sec. 1212.

The shoes for sale and the proceeds thereof were the property of the Petitioner. They were not lent to the Bankrupt. **The lease agreement created an active, express trust.** Manifestly the relationship between the parties was not merely that of debtor and creditor nor so intended.

It is grossly unjust and contrary to established law to vary the terms and conditions of the unambiguous agreement made by the bankrupt with the Petitioner, and to alter the intention manifest in its explicit language. What

cannot be done by violation of the parole evidence rule* should not be countenanced by a judicial excision or obliteration of valid contract terms.

The dissenting Opinion of Judge Swygert (p. ~~13~~ 19 hereof) powerfully supports the reasons why the judgment and Opinion of the Court of Appeals should be reviewed on Certiorari.

We believe that the Writ should be granted not only to rectify a wrong, but in the interest of protecting the rights of thousands of business men who entrust the proceeds of the sale of their merchandise to store owners under written agreements in which the parties stipulate that the proceeds of sale are trust funds, while recognizing as a practical matter that commingling of department proceeds may occur.

Respectfully submitted,

VICTOR PACKMAN,
1096 Arcade Building,
St. Louis, Missouri,
CHARLES R. SPROWL,
WALTER C. CLEMENTS of
TAYLOR, MILLER, MAGNER,
SPROWL & HUTCHINGS,
120 South LaSalle Street,
Chicago, Illinois,
Attorneys for Petitioner.

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* See Sec. 38, Comment (a) of Restatement of the Law of Trusts (1959) 2nd Ed., Vol 1.

APPENDIX

APPENDIX.

In the
United States Court of Appeals
For the Seventh Circuit.

September Term, 1965—September Session, 1965.

No. 15088

In the Matter of
Lord's, Inc., Bankrupt, Chicago Cutter-Karcher, Inc.,
Petitioner-Appellant,
v.
Charles D. Maley, Trustee,
Respondent-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

December 17, 1965.

Before Hastings, Chief Judge, and Knoch and Swygert, Circuit Judges.

Knoch, Circuit Judge. Petitioner-appellant, Chicago Cutter-Karcher, Inc., hereinafter sometimes called "Cutter-Karcher," filed a reclamation petition to recover $17,300.47 claimed as trust funds. These funds resulted from the sale of Cutter-Karcher's shoes and accessories by Cutter-Karcher's employees in the department store of the bankrupt, Lord's, Inc.

The petition was denied by the Referee in Bankruptcy, whose order was affirmed by the District Court on petition for review, and this appeal followed.

On February 1, 1956, Cutter-Karcher entered into a lease with Lord's for space in Lord's store in Evanston, Illinois, where Cutter-Karcher would sell its shoes and related accessories for cash or on credit.

It was agreed that sales would be made in the name of Lord's and recorded by Lord's at its expense, and that all moneys received by Cutter-Karcher's employees would be turned over immediately to Lord's. The agreement provided, however, in Article Sixteenth of the agreement that all the moneys and accounts so received by Lord's on account of sales in Cutter-Karcher's department would be considered to be held by Lord's:

> . . . in Trust for Lessee [Cutter-Karcher], and if mingled with Lessor's [Lord's] funds, either in cash drawer or deposit in the bank, or wherever such commingling may be effected, such funds shall nevertheless and hereby are considered trust funds, and are to be so held by Lessor in trust for Lessee until Lessor has paid to Lessee the total amount of such sales and receipts in accordance with the provisions hereof. In the event title to said funds shall at any time be called into question, the parties hereto desire to clearly indicate their intention that these funds shall be and are hereby considered and regarded by the parties hereto as trust funds irrespective of whether they are commingled or not, and said funds shall be held in trust for the benefit of Lessee.

On June 16, 1964, an involuntary petition in bankruptcy was filed against Lord's. Lord's petitioned for an arrangement under Chapter XI of the Bankruptcy Act. Until September 2, 1964, Lord's operated as debtor in possession under court order. On September 2, 1964, Lord's was adjudicated a bankrupt with its consent, and Charles D. Maley, defendant-appellee in this case, was appointed Trustee in Bankruptcy.

On June 16, 1964, Lord's had in its possession $9,553.16 net proceeds of sales in the leased department during May, 1964.

The Trustee subsequently adopted Lord's answer to the reclamation petition for the $9,553.16 plus proceeds of sales after June 16, 1964. Lord's contended that it held no sums in trust.

After hearing, the Referee in Bankruptcy found that the lease agreement and the conduct of the parties showed a relationship of debtor and creditor and not the creation of a trust. He accordingly denied the reclamation petition.

Cutter-Karcher contends that the lease agreement contained an express trust obligation which Lord's (and the Trustee, in turn) was estopped to deny. In the face of the explicit wording of Article Sixteenth, quoted above, Cutter-Karcher considers that no other conclusion may be drawn despite certain terms of the agreement and actions of the parties which Lord's points to as inconsistent with an express trust, such as failure to provide for creation of a separate fund for deposit of proceeds of sales; failure to denominate the lease a "trust agreement"; and failure to use the terms "trustee" or "beneficiary."

The Trustee appellee asks why did the parties not provide for a separate bank account with the protective features commonly associated therewith; that the parties contemplated these funds would be commingled as they were over a period of years, and that merely denominating them "trust funds" was insufficient to create a trust.

Cutter-Karcher argues that the obligation assumed in the agreement by Lord's to repay by the 15th of each month the proceeds of Cutter-Karcher's sales of the previous month (less certain authorized deductions) even though such sales were made in Lord's name and recorded at Lord's expense, with Lord's guarantee of credit

or charge sales, did not operate to create a mere debtor-creditor relationship, nor to destroy the trust character of the sales proceeds in Lord's hands. Cutter-Karcher asserts that in none of the cases on which the Referee and the District Court rely were there any agreements with an express provision for a trust. That is correct.

In the Matter of the Yeager Company, Mendel et al. v. Whitman, 6 Cir., 1963, 315 F. 2d 864, the facts were very much like those here except that there was no reference to a "trust" in the lease. The court refused to infer one. Reclamation of the fund resulting from sales of Mendel and Marshall merchandise commingled with Yeager funds was denied. Another generally similar factual set-up existed in **In re Martin's,** District Court, New York, 1935, 11 F. Supp. 99, and in **Isaac McLean Sons Co. v. William S. Butler & Co.,** District Court, Mass., 1913, 208 Fed. 730, except that there is no mention of an express trust in the quoted or described terms of the lease. In both cases, the court declined to find an implied trust.

Thus in this case we have before us a set of circumstances similar to those in which courts have refused to imply a trust.

Cutter-Karcher cites **In re Steele-Smith Dry Goods Co.,** District Court, N. D. Ala. S. D., 1924, 298 Fed. 812, where under similar circumstances, the court did imply a trust and found a fiduciary rather than a debtor-creditor relationship as to funds traceable from sales in the leased department to the general bank account of the bankrupt lessor department store.

We have carefully weighed this case against the conflicting decisions and find the reasoning in the cases cited above to be more convincing.

If a trust cannot be implied, is the situation materially changed by the mere use of the term "trust" in one article

of a long agreement in which the parties are designated "Lessor" and "Lessee?"

There is nothing magical in the word "trust" standing alone. As Bogert puts it in Trusts and Trustees, 2nd Ed. 1965, Vol. I, Ch. 3, § 45, p. 316:

> [T]he use of words of trusteeship is not conclusive as to the expression of an intent to have a trust, where incidents foreign to that relationship appear to have been contemplated.

Another equally respectable authority, **Scott on Trusts**, 2nd Ed. 1956, Vol. I, § 24, p. 181, states:

> [T]he mere fact that these words are used does not necessarily indicate an intention to create a trust. The question in each case is whether the settlor manifested an intention to create the kind of relationship which to lawyers is known as a trust, whether the settlor manifested an intention to impose upon himself or upon a transferee of the property equitable duties to deal with the property for the benefit of another person.

All sales here were made in the Lessor's name, all proceeds of such sales were immediately turned over to the Lessor with the understanding that they could be commingled with the Lessor's own funds. Not on demand, but on agreed dates, the Lessor paid a net amount (less certain agreed disbursements, returns, etc.) out of the Lessor's own general funds.

From the time of its receipt until settlement date (at least 15 days) the Lessor had unrestricted use of the funds. A similar relationship in **In re Martin's**, *supra*, was held to be consistent with that of debtor and creditor and not that of fiduciary and beneficiary.

William Hahn and Company, *amicus curiae*, does not rely on the theory of an express trust. It argues that

Lord's accepted a bailment of money which was not converted into a loan by the inability of the bailee to return the identical currency deposited, in the absence of some subsequent agreement for such a loan.

The *amicus curiae* contends that lease-departments in department stores represent a growing contemporary trend; that the decision of the Referee and the District Court would impose a high and commercially unwarranted administrative and bookkeeping expense on lessor and lessee. As *amicus curiae* sees the situation here, Lord's sole function was to account for the funds and to restore them to Cutter-Karcher on the 15th day of each month. The cases cited in support of this argument seem to deal mainly with the question of whether a particular transaction was a bailment or a sale, which is not the question before us.

A number of bailment-sale cases were also cited by Cutter-Karcher. One of these, **In re Warner-Quinlan Co.**, 2 Cir., 1936, 86 F. 2d 103, includes the following statement (at p. 104):

> If the proceeds were to be held in trust, the deposit of such trust funds in the appellee's general account would have been a breach of trust and, if appellant knew that this was appellee's practice, it would tend to show the real understanding between the parties. . . . This would contradict the provision that title to the proceeds of sale vested in the appellant; or, at best, this provision would have to be interpreted as an effort by appellant to obtain security for appellee's obligation, not as the creation of a trust relationship.

The brief of the *amicus curiae* refers to avoidance of administrative and bookkeeping expense by allowing commingling of funds. In another place, in the affidavit in support of the brief, Mr. Gilbert Hahn speaks of the bargaining process between a department store and a pro-

spective leased department operator. He says that a financially strong department store, where risk of financial failure is small, may resist a "trust" clause because of its administrative and bookkeeping burdens, but that a financially weaker store may accept it as a suitable means of minimizing the lessee's risks in the event of the lessor's bankruptcy. Mr. Hahn feels it is unfair to deprive the lessee in such cases of the protection for which he has contracted.

Nevertheless, it appears that in the case before us, a "trust" clause has been inserted into a document which otherwise sets up a simple debtor-creditor relationship in an effort to assure the debtor's performance of its obligation and not to create a trust.

The parties to a department store-leased department agreement may establish a fiduciary relationship as they did in **U. S. National Bank v. Blauner's Affiliated Stores, Inc.**, 3 Cir., 1935, 75 F. 2d 826, where the contract provided for the funds collected to be kept in a separate account for the lessee. The parties have not done that here.

We have considered all other points and authorities to which Cutter-Karcher and the *amicus curiae* have invited our attention, but we find them lacking in merit.

The orders of the Referee and the District Court are affirmed.

Affirmed.

Swygert, Circuit Judge, dissenting.

If I understand the majority opinion correctly, this court is holding that if the circumstances do not permit a trust to be implied, those same circumstances will not create a trust even though the parties have additionally agreed to the creation of an express trust. To my mind this is an illogical proposition.

Here, we are asked to enforce an express trust. There is no need to imply one. Paragraph sixteen of the agreement explicitly and unambiguously shows an intent to establish a trust relationship. Even though the trust is mentioned in only one of several paragraphs of the agreement, the terms contained in the other paragraphs are consistent with the explicit provision that amounts received by Lord's on account of sales in the department leased to Cutter-Karcher should be held in trust for Cutter-Karcher. Other portions of the agreement provide, *inter alia*, that sales in the department were to be made by Cutter-Karcher's employees; that the merchandise was to be purchased by Cutter-Karcher on its credit and that it retained the right to remove its stock and any of its other chattels in the event Lord's breached the agreement. Further, all of the incidental supplies used in the department were to be furnished by Cutter-Karcher. Casualty insurance on all merchandise, workmen's compensation insurance, public liability insurance, and any taxes and licenses were to be paid by Cutter-Karcher. Thus, the entire operation of the leased department was under the control and at the expense of Cutter-Karcher. All sales receipts, however, were to be turned over to Lord's, which was obligated to keep a true and accurate account thereof. Lord's paid Cutter-Karcher's employees from these moneys, but only after Cutter-Karcher's submission of its payroll.

This method of operation enabled Lord's to simplify its bookkeeping system and to retain the twelve per cent of Cutter-Karcher's net sales agreed upon as the cost of leasing the department store space. The balance of Cutter-Karcher's receipts held by Lord's was to be remitted periodically to Cutter-Karcher.

In re Kline, 7 F. Supp. 850 (W. D. Pa. 1934), **aff'd sub nom., United States Nat'l Bank v. Blauner's Affiliated Stores**, 75 F. 2d 826 (3rd Cir. 1935), concerned the collec-

tion of funds by the receiver and the trustee in bankruptcy during their operation of the bankrupt's business. Although it is not entirely clear, it appears that the funds may have been deposited in a physically separate account. The district court stated that by the agreements under which the claimants occupied space in Kline's department store, Kline was merely the trustee in the collection of the moneys due from credit sales by the leased departments. "The agreements so plainly state, and provide for a separate account of these items of money collected."

The majority here, referring to **In re Kline**, says: "The parties to a department store-leased department agreement may establish a fiduciary relationship . . . where the contract provide[s] for the funds collected to be kept in a separate account for the lessee. The parties have not done that here." True, the agreement did not require Lord's to maintain a separate bank account for funds belonging to Cutter-Karcher. But if the majority places its reliance upon the absence of a provision for the physical separation of the trust funds, such reliance is misplaced. Commingling of funds by a trustee does not of itself destroy an express trust. **In re Warner-Quinlan Co.**, 86 F. 2d 103 (2d Cir. 1936); **Southern Cotton Oil Co. v. Elliotte**, 218 Fed. 567 (6th Cir. 1914); **In re Steele-Smith Dry Goods Co.**, 298 Fed. 812 (N. D. Ala. 1924). Section 179, comment (f), of the Restatement of Trusts, 2nd, reads: "By the terms of the trust the trustee may be permitted to mingle trust property with his own property. It may be expressly so provided by the terms of the trust or the character of the trust may be such as to make this proper."

On the other hand, the majority may have attached significance to a supposed failure of the parties to provide a separate accounting procedure for the trust funds. But the Cutter-Karcher-Lord's agreement specifically provides for such procedure. Paragraph ten reads in part: "The

Lessor agrees to keep a true and correct account of all moneys received, growing out of the Lessee's sales, including an account with respect to the Lessee's credit or charge sales, also an account of all moneys disbursed on the Lessee's authorization, and exhibit said records to the Lessee or its representatives upon reasonable request to do so."

I would reverse the order of the district court.

A true Copy:

Teste:

.....

Clerk of the United States Court of Appeals for the Seventh Circuit.

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FILED
JUN 27 1966
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965.

No. [redacted] 208

CHICAGO CUTTER-KARCHER, INC.,
Petitioner,

vs.

CHARLES D. MALEY, TRUSTEE OF LORD'S INC.,
Bankrupt,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION TO CERTIORARI.

NORMAN H. NACHMAN,
38 S. Dearborn Street,
Chicago, Illinois 60603,
Attorney for Charles D. Maley, Respondent.

GERALD F. MUNITZ,
ALLAN G. SWEIG,
Of Counsel.

THE GUNTHORP-WARREN PRINTING COMPANY, CHICAGO

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CITATION.

Case.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965.

No. 1390.

CHICAGO CUTTER-KARCHER, INC.,
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Bankrupt,
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION TO CERTIORARI.

To the Honorable, The Chief Justice and The Associate Justices of the Supreme Court of the United States:

THE OPINION BELOW.

The Opinion of the Court of Appeals for the Seventh Circuit is reported at 356 F. 2d 456 and is set forth in the appendix to the petition.

JURISDICTION.

The jurisdictional requisites are adequately set forth in the petition.

QUESTION PRESENTED FOR REVIEW.

This case arises out of a bankruptcy proceeding and involves the interpretation of a lease between Lord's, Inc. ("bankrupt"), as lessor, and petitioner, as lessee, relating to the operation by petitioner of a shoe department in the bankrupt's department store. At the time of the bankrupt's adjudication, the bankrupt had in its general bank account (which was its only bank account) the proceeds of the sales made in petitioner's shoe department. The only question presented in this case is whether the proceeds from the sales in the shoe department constitute trust funds under the lease. The Referee in Bankruptcy, the District Court and the Court of Appeals all concluded that they were not trust funds. Instead, the courts below held that a debtor-creditor relationship was created and the petitioner was a general unsecured creditor of the bankrupt. This case does not involve a constitutional question, the interpretation of a federal statute, or a question important to the administration of the Bankruptcy Act. This case simply involves the interpretation of a lease.

STATEMENT OF THE CASE.

The lease involved consists of 8 pages and 21 separately designated paragraphs. Among others, the lease contains the following provisions:

a) All sales in petitioner's shoe department were to be made in the name of the bankrupt and the proceeds thereof immediately turned over to the bankrupt.

b) The bankrupt was permitted to commingle the proceeds of petitioner's shoe sales with all of its other funds.

c) The bankrupt had complete and unrestricted use of the proceeds of the shoe sales.

d) The bankrupt had the right to approve and pass upon credit sales, and such approval, when given, was a guaranty by the bankrupt that payment would be received.

e) The bankrupt had final authority to decide and adjust controversies between petitioner and its customers and to charge petitioner's account therefor.

The referee found that during the 8-year period the lease was in effect, petitioner had actual knowledge that the bankrupt maintained only one bank account in which it deposited all of its funds and from which it paid all of its obligations. The Referee also found that the bankrupt periodically was delinquent in making its remittances to petitioner and that petitioner never requested the bankrupt to maintain a separate account or in any other way segregate the proceeds of the shoe sales. The Referee in Bankruptcy, the District Court and the Court of Appeals concluded that the lease, and the conduct of the parties thereunder, created a debtor-creditor relationship.

ARGUMENT.

The only question presented involves the interpretation of a lease. Petitioner urged throughout these proceedings that the lease created a trust. Its corporate affiliate, in the amicus brief filed with the Court of Appeals, argued that the lease created a bailment. The Referee in Bankruptcy, the District Court and the Court of Appeals all held that it created a debtor-creditor relationship.

Clearly, on the undisputed facts and on the rulings below this case does not in any respect affect the administration of the Bankruptcy Act. It is purely a coincidence that the lease question arose in a bankruptcy case.

Petitioner has demonstrated no compelling economic or equitable reason for the issuance of a writ of certiorari. As stated in the opinion of the Court of Appeals, department store lessees may protect their interests merely by requiring the maintenance of a separate account for the proceeds of their sales.

The decision of the Court of Appeals is not in conflict with the decision of another Court of Appeals on the same matter. The decisions of the courts below are correct and in accord with well-established law. The cases cited by petitioner do not deal with the question presented here, that is, whether a trust is created in an agreement which permits the purported trustee to commingle and have unrestricted use of the funds.

Petitioner erroneously states that the Court of Appeals misinterpreted *U. S. National Bank v. The Blauner's Affiliated Stores, Inc.*, 75 F. 2d 826 (3rd Cir. 1935). In its opinion, the Court of Appeals clearly distinguished *Blauner's* on the ground that the funds in that case were not

commingled but were kept in a separate distinct account. Furthermore, petitioner's reference to the lease involved in *Blauner's* is clearly improper since those documents were never made a part of the record in this case but were referred to for the first time in petitioner's petition for rehearing en banc filed with the Court of Appeals.

CONCLUSION.

Respondent respectfully submits that petitioner has failed to demonstrate special and important reasons requiring review of this case on writ of certiorari. Certiorari jurisdiction was not conferred upon the court merely to give the defeated party another hearing. It is respectfully submitted that the petition should be denied.

Respectfully submitted,

NORMAN H. NACHMAN,
38 S. Dearborn Street,
Chicago, Illinois 60603,
Attorney for Charles D. Maley, Respondent.

GERALD F. MUNITZ,
ALLAN G. SWEIG,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1965.

[redacted] 208

CHICAGO CUTTER-KARCHER, INC.,
Petitioner,

vs.

CHARLES D. MALEY, Trustee of Lords, Inc., Bankrupt,
Respondent.

REPLY BRIEF OF PETITIONER TO RESPONDENT'S BRIEF IN OPPOSITION TO CERTIORARI.

VICTOR PACKMAN,
1096 Arcade Building,
St. Louis, Missouri 63101,

CHARLES R. SPROWL
WALTER C. CLEMENTS,
TAYLOR, MILLER, MAGNER, SPROWL & HUTCHINGS,
120 South La Salle Street,
Chicago, Illinois,
Attorneys for Petitioner.

ST. LOUIS LAW PRINTING CO., INC., 415 N. Eighth Street. CEntral 1-4477.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1965.

No. 1390.

CHICAGO CUTTER-KARCHER, INC.,
Petitioner,

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CHARLES D. MALEY, Trustee of Lords, Inc., Bankrupt,
Respondent.

REPLY BRIEF OF PETITIONER TO RESPONDENT'S BRIEF IN OPPOSITION TO CERTIORARI.

Respondent states, on page 2 of his brief, that Petitioner's lease, among others . . . "contains the following provisions". He then purportedly summarizes some of them by substituting in lieu of references, self-serving conclusions for non-existent language, which he could not quote.

We challenge these distortions because the lease does not "contain the following provisions":

> "b) The bankrupt was permitted to commingle the proceeds of petitioner's shoe sales with all of its other funds.
>
> c) The bankrupt had complete and unrestricted use of the proceeds of the shoe sales."

However, the Respondent accurately, but irrelevantly, states the lease provisions provided for a guaranty by the bankrupt of credit sales it approved.

There were similar provisions in the leases that were upheld as providing for a trust relationship in **In re Kline**, 7 Fed. Supp. 850,[1] affirmed (sub-nominee) in **U. S. National Bank v. Blauners Affiliated Stores, Inc.**, 75 F. (2d) 826 (1935). Also see **General Electric Co. v. Brower**, 221 Fed. 597, 601, 2 (9th Circuit 1913); **Ludvigh v. American Woolen Co.**, 231 U. S. 522, 527-9 (1913).

* * * * * * * *

> "A judicial opinion as a precedent is to be read and applied in the light of the facts of the case in which the opinion was written."[2]

Based on the above principle, the three lease agreements[3] before the U. S. Court of Appeals for the Third Circuit, in **U. S. National Bank v. Blauners Affiliated Stores, Inc.**, supra, are important to a true understanding of its holding. Their contents were summarized by the District Judge in his affirmed opinion.

However, the Respondent, **aware of their clarifying effect**, wants to rule out their consideration and argues (page 5) that:

---

[1] Judge Shoonmaker in his summary of the various lease provisions stated:

> ". . .; and that so far as credit accounts were concerned, no credit was to be extended by any of these parties claimant to any person except with the approval of Kline, who guaranteed the collection of such account."

[2] **Robertson v. United States**, 249 F. (2d) 737, 743 (5th Cir.). It cites **Armour v. Wantock**, 323 U. S. 126, 133, 89 L. ed. 118, 123.

[3] They are contained on pages 18 through 37 of the Appendix to the Petition for Rehearing filed in the Court of Appeals in this case (part of the duly certified record herein).

". . . petitioner's reference to the lease involved in Blauners' is clearly improper since those documents were never made a part of the record in this case but were referred to for the first time in petitioner's petition for rehearing in banc filed with the Court of Appeals."

It is true that the leases are not part of the record in the case below in the sense of evidence but since they are referred to in the Blauners' Opinion, those leases are properly a matter of relevance to an understanding of the case.

Respectfully submitted,

VICTOR PACKMAN,
1096 Arcade Building,
St. Louis, Missouri 63101,

CHARLES R. SPROWL,

WALTER C. CLEMENTS,

TAYLOR, MILLER, MAGNER, SPROWL & HUTCHINGS,
120 South LaSalle Street,
Chicago, Illinois,
Attorneys for Petitioner.

MOTION FILED AUG 29 1966

In the

Supreme Court of the United States

OCTOBER TERM, 1966.

No. [redacted] 208

CHICAGO CUTTER KARCHER, INC.,

Petitioner,

vs.

CHARLES D. MALEY, Trustee of LORDS, INC., Bankrupt,

Respondent.

MOTION OF CONSOLIDATED MILLINERY COMPANY FOR LEAVE TO FILE A BRIEF, AMICUS CURIAE, IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

AFFIDAVIT IN SUPPORT OF MOTION AND BRIEF

BRIEF OF CONSOLIDATED MILLINERY COMPANY, AMICUS CURIAE

ALEX ELSON
Attorney for Amicus Curiae

ELSON, LASSERS & WOLFF
11 S. La Salle Street
Chicago, Illinois
Of Counsel

The Scheffer Press, Inc.—ANdover 3-6850

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IN THE

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No. 1390

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MOTION OF CONSOLIDATED MILLINERY COMPANY FOR LEAVE TO FILE A BRIEF, AMICUS CURIAE, IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Consolidated Millinery Company respectfully moves this Court, pursuant to Rule 42 of this Court, for leave to file the attached brief, *amicus curiae,* in support of the petition for a Writ of Certiorari. The respondent has refused to consent to the filing of such a brief. The purpose of the brief is to bring to the attention of the Court important factual matters concerning leasing operations in department stores not presented to the court below. An affidavit setting forth these facts is hereto attached.

The petition seeks review of a decision of the Circuit Court of Appeals for the Seventh Circuit which, if

allowed to stand, will seriously injure many small and independent department stores and many companies engaged in the business of leasing departments in department stores.

Consolidated Millinery Company is engaged exclusively in the business of leasing departments in department stores. It operates millinery departments in over 300 stores. Many of these departments are operated pursuant to leases containing trust provisions similar to the one in question here. Several stores with which Consolidated Millinery Company has such leases have become insolvent. Consolidated Millinery Company has a substantial interest in the determination of this question because the decision of this case will necessarily affect its right under these leases.

Leased departments have become a major factor in modern retail merchandising. The latest study indicates that leased departments account for approximately 10% of all sales in department stores. More than 24% of the stores surveyed leased their shoe departments and over 43% leased their millinery departments. The availability of lessees is especially important to small or marginal stores who operate independently. Often these stores need to establish new departments in order to remain competitive with larger stores. Many of these stores, however, cannot successfully expand on their own because of problems in financing or because a new department would require special experience, equipment, or trained personnel. The only way for a store in this position to remain competitive is to find a lessee to put in the new department for it.

A lessee is especially vulnerable if its lessor becomes insolvent. The lessor may have up to 46 days receipts from the leased department in its possession. The lessee

at the same time incurs expenses not incurred by a general creditor.

The only way a lessee can protect itself is to provide, in the lease, for a trust arrangement such as the one at bar. The decision below holds that any such trust arrangement is void if the lessee's funds are commingled with those of the lessor. Credit sales form a large part of retail sales. Store credit extended to customers by leased departments is required to make possible essential integration of the leased operation. This fact and the cost and inconvenience of treating cash and credit sales separately makes it practically impossible to separate the funds of the leased department. In fact the decision below destroys all possibility of any effective trust agreement.

Besides causing a hardship to lessees who have been operating in good faith pursuant to trust arrangements, the decision below will greatly increase the difficulty small stores will have in finding the lessees they need. Prospective lessees will be less willing to contract with small stores because they cannot protect themselves from the risk involved. These stores will have a much harder time maintaining or improving their competitive position because it will be more difficult for them to add the new departments necessary to attract new customers or keep old ones.

Finally, the decision below provides a windfall to the general creditors. There are several readily available sources from which these creditors could, in the exercise of due care, have discovered which departments the bankrupt leased. The general creditors knew or should have known that they could look neither to the merchandise in these departments nor the receipts therefrom if the store became insolvent.

It is submitted that the above facts should be taken into account by this Court when considering the petition for a writ of certiorari. The effect of the decision of the court below on department leasing cannot be over-emphasized. The probability of serious harm resulting to lessees and lessors should not be overlooked by this Court.

Respectfully submitted,

.....

Alex Elson
Attorney for Amicus Curiae

Of Counsel:

Elson, Lassers and Wolff
11 South LaSalle Street
Chicago, Illinois
Telephone: FR 2-5461

Dated at Chicago, Illinois, August 26, 1966.

AFFIDAVIT IN SUPPORT OF MOTION AND BRIEF

State of Illinois }
County of Cook } SS.

W. Alvin Wineberg, being first duly sworn on oath, deposes and says:

(1) I am the President of the movant herein, Consolidated Millinery Company, an Illinois corporation.

(2) Consolidated Millinery Company is engaged exclusively in the business of leasing millinery departments in various department and specialty stores. Consolidated Millinery Company leases over 300 such departments in 48 states, with sales in excess of $20,000,000.00 a year.

(3) The leases between Consolidated Millinery Company and the various stores usually provide that all receipts from the leased department are to be turned over to the store. The store deducts its rent and various other charges and then returns the remainder to Consolidated Millinery Company on the 15th of the following month. All credit sales must be approved by the store and are handled in the same manner as credit sales at store operated departments. Many of these leases provide that the lessor is to hold the said receipts in trust for the lessee, but do not require separate bank accounts. None of the leases require segregation of funds.

(4) Several stores with whom Consolidated Millinery Company has leases containing such trust provisions, have become insolvent.

(5) I have been engaged in the field of leasing departments in stores for over 30 years, and am intimately familiar with this aspect of retail merchandising.

(6) Consolidated Millinery Company always attempts to secure a trust provision in any lease it signs with a small or marginal store. Depending on the particular store, Consolidated Millinery Company may refuse to execute a lease unless it contains such a provision.

(7) Approximately 40% to 60% of the sales made in departments leased by Consolidated Millinery Company are credit sales.

(8) The publication *Leased Departments: Rates, Policies, and Expenses in Department and Specialty Stores,* published by the Controllers' Congress of the National Retail Merchants Association, 100 West 31st Street, New York, New York, (1965), contains the following information:

(a) 164 Department and specialty stores, varying from $1,000,000.00 to $20,000,000.00 in annual sales were surveyed. (p. 6);

(b) The department stores leased 10% of their departments (median) (p. 6);

(c) The leased department accounted for 10% of the sales in main department stores (median) (p. 6);

(d) Some reasons given by small stores for leasing departments include: Leasing helps broaden a store's merchandise and service offerings; leasing provides the necessary professional management for the department; leasing allows a store to introduce new lines of merchandise or new services with a minimum capital investment risk, and leasing allows a store to expand more rapidly than its own capital permits. (p. 7);

(e) The reporting stores said the lessee paid the following expenses in connection with the leased department: Salaries of sales personnel, 100%; prepara-

tion of payroll tax returns, 91%; advertising space, all but one store; advertising mats, cuts, etc., 96%; license fees, 90%; cash shortages, 74%; customer claims and damages, 91%; Workmen's Compensation insurance, 93%; fidelity bond, 76%; public liability insurance, 67.5%; products liability insurance, 76%; special equipment, 84%; salaries of floor cashiers and wrappers, receiving and marking salaries, advertising heads and tails, publicizing a new leased department, office supplies, delivery by an outside agency, fire insurance on fixtures, and depreciation on fixtures and equipment, all over 50%. (pp. 32-36).

(f) 75.4% of the stores reported leasing their beauty salon, 43.4%, their millinery department, and 25.4% their shoe department. (p. 8).

(9) The publication, "Stores" magazine for July-August (1964), also published by the National Retail Merchants Association, contains the following information:

(a) Of 200 department and specialty stores surveyed, 2% leased only service departments, 75% leased one or more merchandise departments and 23% leased no departments (p. 31);

(b) The median store leasing any departments received 9% of its sales from leased departments, and one out of four stores leasing any departments received 15% or more of its sales from those departments (pp. 31-32);

(10) The publication, *Leased Departments: Rates, Policies, and Expenses in Department and Specialty Stores,* also published by the Controllers' Congress of the National Retail Merchants Association (1958), contains the following information:

(a) 224 Department and specialty stores, ranging from 6 departments to 226, and from annual sales of

less than $1,000,000.00 to more than $20,000,000.00 were surveyed (Forward and p. 8);

(b) Leased departments in department stores accounted for 8% of all sales (median) (p. 8);

(11) The publication, *Leased Department Survey,* published by the Controllers' Congress of the National Retail Dry Goods Association, 100 West 31st Street, New York, New York (1952), contains the following information:

(a) 132 Stores, ranging from 2 departments to 240 departments and from $2,000,000.00 annual sales to $50,000,000.00 annual sales were surveyed. (p. 8);

(b) The median store did 5.2% of all sales through leased departments.

(12) The annual publications, *Sheldon's Retail Trade of the United States,* Phelon-Sheldon Publications, Inc., 32 Union Square, New York, New York, and *The Directory of Department Stores,* Department Store Guide, 2 Park Avenue, New York, New York, usually indicate which departments, if any, in a given department or specialty store, are leased. The edition of *Sheldon's* for 1963 showed which departments of Lord's, Inc., the bankrupt here, were leased and to whom, and showed that petitioner was the lessee of the shoe department.

(13) "Survey of Current Business", July, 1966, published by the U. S. Department of Commerce shows that over 30% of all department store sales are on credit (exclusive of installment sales). Credit sales in January 1966, (exclusive of installment sales) were 54.7% of total sales.

25.8% of all sales were on credit in December 1965, and 35.2% were on credit in May of that year. (pp. S-11 and S-19).

.....

W. Alvin Wineberg

Signed and sworn to before me this
26th day of August, 1966

.....

Notary Public

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1966.

No. 1390

CHICAGO CUTTER KARCHER, INC.,

Petitioner,

vs.

CHARLES D. MALEY, Trustee of LORDS, INC., Bankrupt,

Respondent.

BRIEF OF CONSOLIDATED MILLINERY COMPANY, AMICUS CURIAE

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1966.

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CHICAGO CUTTER KARCHER, INC.,

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Respondent.

BRIEF OF CONSOLIDATED MILLINERY COMPANY, AMICUS CURIAE

INTRODUCTION

Consolidated Millinery Company ("Consolidated") is a corporation, duly existing under the laws of the State of Illinois. For the last 30 years, Consolidated has engaged solely in the retail sale of women's millinery—hats, wigs, etc.—through leased departments.

Consolidated leases millinery departments in over 300 stores in 48 states. Its annual gross sales from these departments is in excess of $20,000,000.00. Typically, the leases provide: all receipts—cash and credit—from sales in these departments are turned over to the store; the

store deducts the rent and various other charges; and the balance is returned to Consolidated by the 15th day of the following month. All credit sales must be approved by the store and are handled by the store credit department in the same manner as credit sales in departments operated by the store. Many of Consolidated's leases have trust provisions similar to the trust provision in the lease to which petitioner is a party. None of these leases require segregation of funds.

The adjudication of the issues in this case are of vital importance to Consolidated and the many other companies engaged in the leasing of departments in retail stores. It is to protect its own interests and to acquaint the Court with certain information about retail leasing operations that Consolidated seeks to intervene in this petition as *amicus curiae*.

ARGUMENT.

I.

THE DECISION BELOW IGNORES THE IMPORTANCE OF DEPARTMENT LEASING IN DEPARTMENT AND SPECIALTY STORES AND WILL AFFECT A SIGNIFICANT PORTION OF TRADE AND COMMERCE.

Leased departments account for a large segment of the operations and sales volume of department and specialty stores. In 1965, a study of department leasing was published by the Controllers' Congress of the National Retail Merchants Association, entitled: *Leased Departments: Rates, Policies, and Expenses in Department and Specialty Stores* (hereafter "*Leased Departments*, 1965.") The survey included 164 Department and specialty stores, varying in annual sales from $1,000,000.00 to over $20,000,000.00. As a median, department stores leased 10% of their departments and received 10% of their sales in main stores from leased departments. (*Leased Departments*, 1965, p. 6).

Similar studies were also conducted in 1952, 1958 and 1964. The pertinent information from these studies is contained in paragraphs 9, 10 and 11, of the Affidavit, *supra*. These data establish that leased departments are a significant aspect of modern retail merchandising, and that leasing operations are increasing. In 1952 leased departments accounted for a median of 5.2% of the sales volume of the department stores surveyed. By 1957, this has risen to 8%, by 1964, 9%, and by 1965 10%.

These figures do not tell the entire story. Some departments are leased much more frequently than the

figures indicate. The 1965 report showed that 75.4% of the stores reported leasing their beauty salon, 43.4%, their millinery department, and 25.4%, their shoe department (*Leased Departments*, 1965, p. 8).

II.

REFUSAL TO GIVE EFFECT TO THE EXPLICIT TRUST PROVISIONS IN THE LEASE WILL BE DETRIMENTAL TO MANY SMALL OR MARGINAL STORES.

The decision below will inhibit the making of leases in small or marginal department stores. This will place such stores in a serious competitive disadvantage.

The trend in recent years has been to put more and more kinds of merchandise under one roof or in one area. In order to remain competitive under these circumstances, the small or marginal store must continue to expand its variety of merchandise and services. But expansion often requires expensive equipment, trained personnel, a heavy outlay of capital, intimate familiarity with special merchandising problems resulting from sudden changes in fashion or style and access to key sources of supply of merchandise. (*Leased Department*, 1965, *supra.*, p. 7). Limited resources are a bar to such essential expansion.

This dilemma can often be solved by leasing the department to someone with the necessary equipment, experience, etc. However, it may not be easy for a small or marginal store to find an acceptable lessee. A lessee considering taking over or starting a department always has to consider the increased possibility of insolvency presented by a small operation. Under the typical lease, the store will have up to 46 days' receipts of the leased de-

partment in its hands from time to time. Trust provisions similar to the one in the present case are frequently put into leases to protect the lessee from losing these receipts if the store becomes insolvent. The decision below, if left standing, will prohibit such provisions and make leasing companies very reluctant to do business with small or marginal stores. This, in turn, will result in fewer of these stores being able to retain or improve their competitive positions.

III.

THE REQUIREMENT OF THE MAJORITY BELOW THAT THE LESSEE'S FUNDS IN THE HANDS OF THE LESSOR BE SEGREGATED EFFECTIVELY PROHIBITS A TRUST ARRANGEMENT IN DEPARTMENT LEASING.

One of the essential characteristics of an effective leased operation is that it be fully integrated into the store. Integration assures retention of customer loyalty. As far as the customer is concerned, the leased operation is just another department in the store.

Integration is achieved by the lessee doing business in the name of the store and using all of the stores' services —including the credit department.

The use of the credit department is of prime importance. Integration would be defeated if a customer could not use his charge account throughout the store. Under the typical lease, credit can only be extended by the store and is guaranteed by the store.

Much of modern retail merchandishing is done on a credit basis. The July, 1966, edition of "Survey of Current Business" published by the United States Depart-

ment of Commerce, shows that well over 30% of all department store sales are credit sales. In January, 1966, department store sales in the United States totalled $1,564,000,000.00. Credit sales (exclusive of installment sales) were $855,000,000.00 or 54.7% of total sales. In the last 8 months of 1965, credit sales (exclusive of installment sales) in department stores varied from 25.8% of total sales in December to 35.2% in May. No comparable statistics are available for installment credit sales, but they would add to these percentages. ("Survey of Current Business", *supra*, pp. S-11 and S-19).

Apart from considerations of integration, customer inconvenience and increased bookkeeping, accounting, and collection expense would make it practically impossible for a lessee to carry on its own credit operation.

The court below did not take these factors into consideration in basing its decision on the admitted fact that the receipts of petitioner were commingled with funds belonging to Lords, Inc., the bankrupt. The court said:

> "The parties to a department store-leased department agreement may establish a fiduciary relationship as they did in *U. S. National Bank* v. *Blanner's Affiliated Stores, Inc.*, 3 Cir., 1935, 75 F. 2d 826, where the contract provided for the funds collected to be kept in a separate account for the lessee. The parties have not done that here." (Petition for writ of certiorari, p. 19).

The requirements of the court below could be met only if the store placed a cash amount equal to the credit sales of its leased departments into a separate account as fast as those credit sales were made. This would visit undue hardship on the store. As the month progressed, it

would find larger and larger amounts of its working capital tied up in the special accounts, non-recoverable until after the end of the month when the store's customers paid their bills. Further, this hardship would be visited only on those stores least able to absorb it—the small or marginal stores which can attract acceptable lessees only by agreeing to some kind of effective trust arrangement. The effect of the decision below is to make any such trust arrangement impossible, and therefore to greatly diminish the competitive abilities of these smaller stores.

IV.

THE RULING OF THE COURT BELOW FAILS ENTIRELY TO TAKE THE SPECIAL VULNERABILITY OF A LESSEE INTO ACCOUNT.

The effect of the ruling below is to prevent a lessee from becoming anything other than a general creditor if the lessor-store fails. But the lessee's risks are much greater than those of a general creditor who risks only the price of the goods sold to the store on credit. If the store goes bankrupt, the general creditor loses only some part of his investment. Under the decision below, the lessee will lose not only part of the cost of the goods he has brought into the store but, also advances for additional expenses not borne by the general creditor.

Leased Departments, 1965, *(supra)* shows that the greatest percentage of lessees bear such expenses as salaries of sales personnel, preparation of tax returns, advertising, license fees, cash shortages, customer claims and damages, insurance of various kinds, special equipment, and so forth. The exact figures reported are contained in sub-paragraph 8(e) of the Affidavit, *supra*.

All of these expenses are in addition to the rent the lessee must pay. Most are expenses which the lessee must bear whether or not the lessor is able to meet its obligations at the end of any given accounting period.

Another major difference between lessees and general creditors should be noted. Most suppliers sell things to many stores, so their entire business is usually not threatened if one goes bankrupt. A lessee's entire business is tied up in that store. Because it is integrated into the store, it has built up no customer loyalty of its own. Further, the store may have a substantial sum of the lessee's money in its hands. The lessee loses its business, and, under the decision below, its receipts if the store fails.

The only way a lessee can protect itself from a blow of this kind is to include a trust agreement like the one in question in the lease. The opinion below effectively prevents this.

V.

THE DECISION OF THE COURT BELOW OPERATES AS A WINDFALL TO THE GENERAL CREDITORS.

The general creditors of the bankrupt either knew, or in the exercise of reasonable diligence, should have known that the bankrupt had leased the shoe department to petitioner. At least two publications, generally available to companies in the merchandising field, indicate which, if any, departments in a store are leased. These publications are: *Sheldon's Retail Trade of the United States*, Phelon-Sheldon Publications, Inc., 32 Union Square, New York, New York; and *The Directory of Department Stores*, Department Store Guide, 2 Park Avenue, New York, New York. The 1963 edition of *Sheldon's* shows

that the bankrupt leased four departments and to whom they were leased.

The effect of the decision below is to give creditors a pro-rata share of petitioner's funds in the hands of the bankrupt. This is windfall because they could not reasonsably have expected to look to receipts from any leased department if the store became insolvent.

CONCLUSION

Department leasing in department and specialty stores is an important aspect of modern merchandising. It is especially important to stores which are small, marginal, or in temporary financial difficulties. The decision of the court below will have a serious adverse impact on this important part of our retail economy and should be reviewed.

Respectfully submitted,

ALEX ELSON
Attorney for Amicus Curiae

ELSON, LASSERS & WOLFF
11 S. La Salle Street
Chicago, Illinois
Telephone: FR 2-5461

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